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Stanley Black & Decker, Inc. (SWK)

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MANAGEMENT DISCUSSION SECTION

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

All right. Good morning, everybody. Thanks for joining us on day two. We're going to keep things rolling with the team from Stanley Black & Decker. We have Stanley's new CFO, Patrick Hallinan, joining us as well as a familiar face in Investor Relations, everyone knows Dennis Lange. So Patrick, if you want to just kind of give us some opening remarks. I know you have some slides online, maybe refer to folks at home can click along, but, maybe give us the lay of the way, first and we'll dive into some Q&A.

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

Yeah. I think I've just spent the morning here today, first time at this conference. A lot of the attendees probably know the company as well or better than I do at this point. But obviously a company in the midst of a transition, Don, and the board streamlined the portfolio, focusing on two businesses, the Tools & Outdoor business, that's about 85% of our revenue and Industrial business, that's about 15% of our revenue.

Put in motion a cost transformation, about a year ago, and objective is to drive [audio gap] (00:01:13) out of the business by the end of 2025, both to return the margin to where it should be and will be, but also to create the room to invest for growth [audio gap] (00:01:27-00:01:33) cost transformation journey, we've delivered, at this point in time, about $600 million of cost transformation since the program has started. We're running a bit ahead of schedule and have every confidence we're going to get to that $2 billion.

We've also been driving a lot of inventory out of the business, about $1.4 billion in the last year or so. And once we get to the end of this year, we probably still have another $1 billion, $1.5 billion in inventory to take out of the business. And as we get the balance sheet cleaned up and the cost structure in place, you're going to see the focus on growth accelerate. It's not that we ever lost that focus, but certainly now that the supply chain is healed and the margin structure allows you to invest appropriately in SG&A, we'll be on a growth journey from this point forward.

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QUESTION AND ANSWER SECTION

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Excellent. Maybe just, if you could, give us a bit of an update of what you're seeing out there. Obviously, demand environment [ph] has been (00:02:37) pretty rich and nuanced this year. I know for your own profitability and kind of the journey here, obviously, a lot of that more internally focused, but any observations, externally, in terms of customer demand or their own inventory levels or any categories you'd point out?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. I'll talk to, first, demand and the demand environment and then the channel inventory environment. I would say, consistent with the comments we made at the end of the second quarter and consistent with I think some of the big US retailers at the end of their quarter, about a month later, we've seen the pro very much engaged and probably stronger than we would have expected this year, and nothing has kind of wavered there.

I'd say, on the consumer side of things, we certainly have seen more price sensitivity at higher price points. And I think that's consistent with what the retailers [ph] have (00:03:37) experienced. I don't think there's been kind of a new wrinkle in demand since our second quarter remarks. What I would say is we're expecting the macro to be about where it is. I mean, central banks seem being poised to be biased towards defense, and that's where they've been. I'd say, given that posture, this year has been better than we might have otherwise thought from just a pure avoidance of recession. We'll see if that still holds true, but I think we feel that the demand we're getting now is likely the demand we see for the balance of this year and into the front half of next year.

For us, channel inventories are in a reasonable, I'd say they're at the low end of what [ph] would (00:04:29) be a normal range for us personally. And I'd say that that's true whether you're talking pro-centric channels or consumer-centric channels, whether you're talking the US or other regions of the world. So we don't see a big channel inventory issue. We certainly have more inventory on our own balance sheet than we'd like to. Like I said, probably by the end of this year to the tune of $1 billion to a $1.5 billion.

But we're going to work that off slowly. We're not going to be using price as a lever to get after that. And we also have some production and distribution footprint changes that'll be taking place in the US and elsewhere over the next year-and-a-half, two years. The part of the pacing of that inventory will be to ensure service levels as we make those transitions.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Understood. I think as categories go, there's probably, one category that folks have noticed a bit more volatility on, on the outdoor side. I know that's an area that was a little bit of a headwind in 2Q. A lot of that maybe attributable to weather or at least early on, but any sort of normalization or inflection/deflection there to note?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. I would say, as this year has played out, our Tools demand has probably been better than we would have anticipated and Outdoor, softer. And whether that's due to the weather in the first half of the year, or whether that is due to a little bit of COVID hangover is hard to discern at this point with any kind of precision. I would certainly

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say, the winter season at the end of 2022 was softer than anticipated; both 2022 and 2023 spring-summer, softer than anticipated. Again, I think part of that must be because it spans more than just any one couple-month period. More than weather, it must be a little bit of that COVID overhang.

I think we're prepared as we head into this winter for a little bit of that same dynamic to be playing out, where that consumer price sensitivity has the demand in the outdoor space dialed a little bit down from where we would otherwise desire. But hopefully, we exit 2023 with most of the post-COVID dynamics playing out, and we can get into 2024 and be kind of through kind of a COVID whipsaw on demand. But we're going to be gating our procurement and production with that in mind, both with the fact that channels seem to be poised to be conservative on inventory and we're still trying to find our footing post-COVID.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Understood. If I think about the inventory destocking, the internal inventory destocking that you're going through, how should I think about sort of this return to normalized production that we're approaching versus the remaining inventory you'd still like to bring down? It seems like it would be a headwind to margins at some level. But I guess, there's a little bit of a definitional question like what is normalized production mean and where do we ultimately see kind of the uplift when destocking is thoroughly done?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. I think appropriately, Don and the team, over the last year, especially the back half of 2022 and the early part of 2023, where we really pushed production way down to address both falling demand and the inventory that was on the balance sheet at the time. That, when you're talking about many plants at 30% or sometimes even less than that level of normal production levels, that's a pretty dramatic effect. Definitely had an effect to the full year P&L this year.

I think we're through most of that by the end of the first quarter. I mean, I think next year, given where the macro is and given some of the outdoor dynamics, could we still have some softness in production, but nothing as dramatic as the second half of 2022 or the early part of 2023. And I don't see production curtailment as a main driver of the gross margin in 2024. I think the drivers of the gross margin in the 2024 are what's the macro, so are you getting kind of any volume leverage or not? What is deflation and is our cost transformation on track?

And so I still think getting into the low 30 percentile by the end of 2024 is very much in the cards, even if, you have modest macro and even if you don't have a dramatic deflationary tailwind at your back. I think, we're making that 35% gross margin by the end of 2025, largely a self-help journey that is not predicated on a big volume tailwind or a big deflationary tailwind. And we're going into next year expecting, still this kind of modeled macro environment where you have defensively postured central banks, you have a war in Ukraine and those things are weighing on demand as they are right now.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Understood. On the cost savings you mentioned, things were going there a little bit better than expected. Any particular areas of success that you'd want to point out?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

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I think two areas have been particularly quick to returns and particularly powerful, both strategic sourcing across our enterprise, but in particular in the Tools & Outdoor business. And then, lean and continuous improvement inside our facilities across the enterprise, but inclusive of and especially in the Industrials business. Then two of the more powerful levers, I think as the next two years play out, that's when we see not just those dynamics continue, but layered into it, the cost savings from taking out facilities – redundant facilities in both production and distribution.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Understood. I guess, within that then on the cost side, how should I think of maybe the other piece of that? So there's been, I'll call it, this acute cost environment for you guys really even predates the wave of inflation and supply chain crunch going all the way back to tariffs.

Some of those things have probably relaxed and maybe improved like transportation. But how should I think about kind of that overall cost picture over the last several years, or maybe the price/cost picture, because you absorbed a lot of inflation, you did get some price, you did take some countermeasures. But are those still kind of a big kind of net headwind today or between deflation and countermeasures and price, have you largely offset some of those?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. And Dennis, correct me if I misspeak here. I want to say, cumulatively, including kind of our outlook for this year, you'd say a three, four-year cumulative cost inflation in the $2 billion, $2.25 billion, and kind of pricing to offset that in the $1.5 billion-$1.7 billion range, so you still have costs ahead of price. I'd say part of the cost journey we're on now from 2023 through 2025 to take the $2 billion of cost out of the business. Part of that is an acknowledgment of we're not likely to be pushing meaningfully new price through the system. And so it's cost structure change and it's structural cost structure change that re-heals the margin back up towards 35%.

And I don't think – while we've seen some very nice transportation savings, both ocean and ground, some of that was in our guidance and some of that has been in the guidance updates we made this year. And we've seen on the margin some metals, we haven't seen a broad-based collapse in commodities. And we'll – I don't expect that to be the case unless there's a broad-based change to the macro.

I think some things like copper and resins have been kind of surprisingly resilient through this part of the process. So we're expecting, as we go through the balance of this year and as we go into next year, just modest deflation. It's not a tailwind we're expecting. We're going to use self-help to reclaim the margin. And we don't expect big pricing dynamics up or down.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Got it. So sticking with kind of the cost side of the equation and the journey there. Nearshoring is something you guys were doing before it was popular and before we had all these new fancy terms for it [ph] front-shoring, Jersey-shoring (00:13:29) or whatever else we need to do.

How is that calculus evolved over time? Clearly, more supply chain inflation probably drives, more accretive actions on nearshoring. But technology has probably changed or improved. Like, has your strategy around that

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really evolved as a function of what maybe that backdrop has changed since you started doing this, gosh, what, seven, eight years ago now?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.
A

Yeah. I don't know that I have all the history of the journey. I think, as I've gotten up to speed in my five or so months, my understanding is we moved somewhere in the neighborhood of 5% to 10% of the volume from China to NAFTA, mostly Mexico. And we have a roadmap to continue that, especially in the next year, around more outdoor and power tools in Mexico.

I look at that as that's a de-risking of the supply chain. And also, as you do more of it, you get the working capital benefits that come with it. But the pace at which it's moving is really the pace at which we can stand up and create the quality and capability of engineering capacity in Mexico and the supplier network in Mexico and in southern US to replicate the strength of those things that were built over two or three decades in China.

And so I think that pace will continue, but I think the pace will be modest in that it's going to go at the pace at which you build up the engineering capability, and the pace at which you build up the supplier network, which is – it's a measured pace. I think from a pure risk management perspective, you'd like it to be faster than it is. But if you just swung production over here and then got exposed to lower quality suppliers not supporting you in the way you can rely on, that's just a different form of risk.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC
Q

Right.

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.
A

So I think, we're kind of moving it at the pace at which engineering and supplier capability transitions.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC
Q

No, since some of the supplier pieces of that are at least somewhat beyond your control, like how much are you able to really influence that? Obviously saying, hey, there's a bunch of business waiting for you at the end of this road once you ramp up capacity, is it being a challenge or a more complicated discussion to help stand that up? Like do you have to help provide them some amount of either, guaranteed business or help them with their capitalization? How does that discussion work?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.
A

It's certainly – fortunately, you do have somewhat of an automotive base to build off of in certain commodity sectors. But you do end up much the way you do when you do strategic sourcing, you do a bit of supplier development, because you're trying to create in the realm of strategic sourcing competition. And you're trying to get more equal competition and strong competition among suppliers.

In places like Mexico, where you just don't have that, you end up with a supplier development capability that comes usually from your procurement [ph] org (00:16:36). And you're sometimes you're having to get them up learning curves and that's why it takes time. And then to your point, work with them to ship volumes in a

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guaranteed basis over time. But it's a gradual process. I'm less close to it at Stanley in my five months, but in my prior life, that's what we were doing. We had started to build a separate supplier development capability in Mexico to do just that.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Understood. Maybe pivoting over to growth and I have a few kind of different areas I want to discuss in that regard. Maybe just starting with the macro-overlay there, you mentioned that the Pro was a little stronger. I feel like, I always try to put in context as I'm talking to folks that, houses don't necessarily buy tools, the contractors do. And we certainly don't have an excess of contractors or folks that are going to be leaving the industry based on lack of activity for them to work on. How do I think about sort of the growth algorithm or growth potential in the Pro categories, just given that contractor won't go, they'll probably continue to go up, maybe limited by the number of warm bodies. But how do you think about kind of that model as it influences the way you look at demand?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. I think we feel like 2024 macro aside, which I think, we're going to be in 2024 sorting through Central Bank war and oil inflation. But the medium, longer term growth trajectory given to your point that you have an undersupply of housing, you have reshoring of either production and or distribution more in North America, and you have some infrastructure build. I think, we feel like there's very helpful tailwinds over the medium, long term.

Then, those macros then also get supported by as battery technology has allowed more applications of higher power tools that allows battery-oriented tools to displace things that were driven by air compressor or other forms of energy. So there's that avenue. And then for us, we spent some years prior to the past very focused on a diversified industrial inorganic strategy. And we have to get back to some of our traditional focus of driving innovation, of driving field sales, service and support and focus on brand level organic growth as opposed to a lot of M&A and a lot of integration of M&A.

So I think when we talk about Stanley Black & Decker growth 2024 and beyond, we're going to be talking about the macro. We're going to be talking about innovation, including expanding where battery gets used in power tools. And then we're going to be talking about getting back to some of our traditional operating models and brand growth models.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Are there initial targets for share gain that are clearly out in front of the rest, whether it's specific channels, customers, product categories and anything that really stands out as a day-one initiative there?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. I would say, we have many, many brands in our portfolio, but I anticipate as Chris Nelson, who's been on board as Head of our Tools & Outdoor business, works with Don, works with the board, continuing Don's focus on let's be much more focused and let's be much more streamlined. You could see probably Chris and the Tools & Outdoor team pick four to six of the biggest brands and really focus the innovation and the brand building and the field support on those four to six biggest brands across both Tools & Outdoor.

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And so I'd say, it's going to be brand-led and innovation-led growth. Some of it will be an expansion of where battery plays and some of it's just going to be a reinvigoration of brands that maybe didn't get the attention over the last three to five years as we were doing so much M&A and integration work.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

Understood. And I guess what does innovation look like in the Tools business these days? I think in Outdoor, it's sort of a clear like kind of gas to battery, but if I think about the major changes to Stanley's line card over the last several years, clearly FLEXVOLT was very game changing. You kind of cut the cord on a bigger piece of the portfolio. What are the big opportunities from here? It seems like battery is just getting smaller, lighter, more powerful. Those are all good, but they sound more incremental. Is there anything, I guess, more game changing that folks should think about is an opportunity, if the technology were to come on?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

A

Yeah. I'll start and Dennis maybe you can add to it because you have a broader runtime of where the innovation is played. But as I've been here five months and I've gotten through a couple innovation sessions with the Tools & Outdoor team. I'd still say there's more room to run of where batteries can be impactful, whether they're replacing gas or compressors in Pro Tools, and both areas like concrete and areas like handheld outdoor products that are beyond things like blowers and trimmers where the battery's been playing out. But you're getting to the point where you have battery powered chainsaws that can beat the top line engine driven chainsaws. And you're getting to the point where you have concrete tools and nailers that are outperforming compressor-driven equivalents. And so I think there's still more runway to go from that.

And then, we also have an opportunity inside our own portfolio to [ph] increasing these (00:22:55) platforms. So when we're going about driving some level of innovation, how do you also drive the level of platforming that allows you to get a better cost basis and maybe more automation in assembly. So I think that there's avenues both on delighting the end user and there's also avenues on improving the cost basis. But I don't know what you'd add to that, Dennis.

Dennis M. Lange
Vice President-Investor Relations, Stanley Black & Decker, Inc.

A

Yeah. I mean, if you think about the core model, it's going application-by-application and just making the existing contractor more efficient and effective at their jobs. And that saves time, saves money, et cetera for the contractor. So they see the value of that. But it also brings news to the category in a way that reinvigorates your brands.

And then you have kind of the bigger swings that Pat was talking about. And this industry, power, runtime and safety and ergonomics has been important for our users. And while, there's continued advances in all of the electronics, the motors, batteries, they continue to push forward in a way that you're taking out new applications that couldn't be done efficient – or effectively or in a cost-effective way with battery in the past. And we continue to see a lot of opportunity on that front.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC

Q

And I guess kind of marrying the two things, we talked about this [ph] more (00:24:06) the cost journey as well as the growth opportunity and some of the innovation, Tools & Outdoor sort of capture a few of those things.

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Obviously, a big area of electrification, you guys have made investments there as well with MTD. How would you characterize the level of competition, the level of customer uptake on electrified product maybe versus traditional? How has that journey gone?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.
A

Yeah. I mean, I think the competitive dynamics have been, at least from what I've been able to assess on my five months here, relatively stable, that we have very good, very capable competitors. So we're going to have to be at the top of our game to delight end users and delight channel partners. But we feel like we're equipped to do that.

I think, in terms of uptake, I'd say – we made a big outdoor acquisition a couple of years ag, I'd say on the handheld, walk-behind transition to electric, I'd say that's at or above the pace we would have anticipated in that outdoor equipment transition. I'd say when you're talking large format like ride-on, whether it's for the consumer or for the pro, I'd say that's slower than we would have anticipated, and I would expect it to kind of keep going at that pace.

And that the performance and cost basis, that's going to apply – that's going to appeal to the consumer for that larger format. I don't think the industry is there yet. I don't think that's just us. I think broadly there's just not the cost/benefit there yet. So I think it will happen just like more and more of automotive will make that transition. But I think it's going to be at a much more measured pace than we or others would have anticipated a year or two ago.

Joshua C. Pokrzywinski
Analyst, Morgan Stanley & Co. LLC
Q

Understood. So putting all this together, you guys were – as part of this journey kind of identified maybe where the landing zone is for 2024 in that $4 to $5 range, understanding there is sort of this exit rate phenomenon that's taking place. I think, for most folks, kind of the internal calculus from here is how much of – would that $4 to $5 is sort of a baseline of which, we resume normalized growth versus are there a lot more incremental, discrete items that you would say, okay, never mind what revenue is over next few years, there's still x hundred million dollars of cost being taken out. Any way to maybe thread the needle on that or define that a little bit more just what we could at least think about order of magnitude post 2024?

Patrick D. Hallinan
Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.
A

Yeah. Well, I'd say as you referred to some of the expectation Don had half a year, a year ago, I still think that's very much in the ZIP Code. I think next year will play out based on where the macro is on the margin, what our level of investment is and where deflation is. And we'll kind of give you that update. But we're coming out of this year. This is consistent with the guidance we gave at the end of Q2 with a very kind of healthy trajectory that kind of points to that ZIP Code.

I think beyond that, we still have $1 billion of cost out after the end of this year, and we have a lot of confidence in that. I would say, as Chris has come on board and as Chris and Tamer and I work under Don to take his vision forward, we're working to see, can we and should we be pushing that gross margin up from there. And what is the right long-term algorithm for this business. And I think we feel like, if we set the right priorities and we stay focused on those priorities, we have every bit the ability to get the EBITDA margin to the high teens, if not into the low-20s. And that's what we're focused on.

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And with a really healthy gross profit margin, that's at least 35%, if not higher than that, I think you want to be at that level, if you're going to be able to invest in innovation and brand consistently throughout the cycle and whether or not you go higher or lower than that is predicated on where do you see the growth opportunities, right? The more you see growth opportunities that might have your gross margin be on the lower side of the range, the more you see, something like growth that's mid-single digits and thereabouts, you might push that margin up a little bit higher. But we're trying to drive the business to at least mid-single digits growth, at least 35% gross profit margin. And to the extent we can push one or both of those higher, we will, because we're trying to get to the business to high teens, low-20s EBITDA margin.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Understood. Crystal clear. And I see we're out of time. So guys, I really appreciate you taking the time. Thanks for joining us and we'll leave it there. Best of luck to you.

Patrick D. Hallinan

Chief Financial Officer & Executive Vice President, Stanley Black & Decker, Inc.

Well, thanks Josh.

Dennis M. Lange

Vice President-Investor Relations, Stanley Black & Decker, Inc.

Thank you.

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